HIGH COURT FOR THE STATE OF TELANGANA

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INCOME TAX TRIBUNAL APPEAL NO.561 OF 2006

Between :

M/s.Pipelic Energy Software India Pvt.Ltd.,
Presently known as Energy Solutions International
(India) Pvt. Ltd., presently at 201, 2nd floor,
Manjeera Trinity Corporate, JNTU – Hitech City road,
Kukatpally, Hyderabad, rep.by its Director K.Venkata
Siva Rao, s/o. Sri Nageshwar Rao, Aged about 33 years,
r/o.Hyderabad.

...Petitioner

and

The Deputy Commissioner of Income Tax,
Circle 1(3), Hyderabad.

.... Respondent

DATE OF JUDGMENT PRONOUNCED : 28.06.2024

HONOURABLE SRI JUSTICE P. SAM KOSHY
AND
HON'BLE SRI JUSTICE LAXMI NARAYANA ALISHETTY

1. Whether Reporters of Local Newspapers may be allowed to see the Judgments ? : No

2. Whether the copies of judgment may be marked to Law Reporters/Journals : **Yes**

3. Whether Their Lordship wish to see the fair copy of the Judgment ? : Yes

*** HONOURABLE SRI JUSTICE P. SAM KOSHY**
AND
HON'BLE SRI JUSTICE LAXMI NARAYANA ALISHETTY

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...Petitioner

Vs.

$ The Deputy Commissioner of Income Tax,
Circle 1(3), Hyderabad.

.... Respondent

!Counsel for the appellant : Sri S.Ravi, senior counsel
rep. Ms.K.Prabhavathi

Counsel for the Respondent : Sri Vijhay K Punna, standing
counsel for Income Tax
Department

<Gist :

>Head Note:

? Cases referred:
(1996) 6 SCC 611; 2012 SCC Online Del 4587; AIR 1961 SC 1028; [2012) 17 taxmann.com 160 (Delhi)]; [2014] 49 taxmann.com 128 (Bombay); [2021] 128 taxmann.com 244 (Madras)]; 241 ITR 166; 1951 SCC 440

HONOURABLE SRI JUSTICE P.SAM KOSHY
AND
HON'BLE SRI JUSTICE LAXMI NARAYANA ALISHETTY

INCOME TAX TRIBUNAL APPEAL NO.561 OF 2006

JUDGMENT: *(per Hon'ble Sri Justice Laxmi Narayana Alishetty)*

The present appeal has been filed under Section 260-A of Income Tax Act, 1961 (for short, the "Act, 1961") assailing the order passed by Income Tax Appellate Tribunal, Bench-B, Hyderabad (for short "Tribunal") in ITA No.148/Hyd/2005, dated 08.02.2006 for the Assessment Year 1999-2000. Vide impugned order, dated 08.02.2006, the Tribunal allowed the appeal filed by the respondent herein setting aside the order of the Commissioner of Income Tax (Appeals) II, Hyderabad (for short, 'CIT(A)'), dated 20.12.2004.

2. Heard Sri S.Ravi learned senior counsel representing Ms. K.Prabhavathi, learned counsel for appellant and Sri Vijhay K Punna, learned standing counsel for Income Tax Department appearing on behalf of the respondent.

3. The brief facts leading to filing of present appeal are as under:

4. The appellant-company was incorporated on 19.12.1997 for carrying on business of consultants and advisors for supply of

industrial computer software systems for use in oil, gas, water pipelines etc. The appellant filed its return on 24.12.1999 for the assessment year 1999-2000 declaring a loss of Rs.55,68,141/-. The said return was processed under Section 143(1) of the Act, 1961 on 29.12.2000 and a refund of Rs.4,194/- was issued to the appellant company.

5. The case of the appellant was selected for scrutiny and notices have been issued under Section 143(2) of the Act, 1961 to the appellant. During the course of assessment proceedings, the Assessing Officer observed that appellant has incurred certain expenditure and claimed the same as business loss and called for explanation from the appellant. That in response, the appellant submitted all the documents as called for by the Assessing Officer in support of its claim. On due verification of the same, the Assessing Officer had disallowed the claim of appellant on the ground that the same has not been incurred for the purpose of business. In fact, the appellant has provided support services to the parent company of the appellant and claimed the said expenditure as business loss.

6. The Assessing Officer further observed that appellant has debited an amount of Rs.42,000/- towards fee paid to the Registrar of Companies for increase of authorized share capital from 1.00

crore to 2.4 crores under the head 'rates & taxes'. However, the Assessing Officer disallowed the said expenditure taking into consideration the decision rendered by the Hon'ble Supreme Court in **Punjab State Industrial Development Corporation** [225 ITR 792] and also **Brooke Bond (India) Ltd.,** [225 ITR 798] and consequently, a demand of Rs.7,763/- against the appellant vide assessment order dated 26.03.2002 under Section 143(3) of the Act, 1961 was issued.

7. Aggrieved by the assessment order dated 26.03.2002, the appellant filed an appeal before the CIT(A). The CIT(A), on considering the memorandum and articles of association of the appellant company, held that appellant-company was set up for carrying on the activity of advisors and consultants of the parent company in India and such allied activities. That the Assessing Officer has erred in taking the view that appellant has not carried on business activity during the previous year under consideration for claim of expenses as revenue expenditure. The learned CIT(A) further observed that appellant was in readiness to receive the clients to render services and consultation and finally held that the view of the Assessing Officer that the business of the appellant has not commenced is to be held as not justified. Therefore, he is directed to allow the expenses claimed as revenue expenditure and

determine the income/loss in the light of above observation and accordingly, allowed the appeal vide order dated 20.12.2004.

8. Aggrieved by the appeal order dated 20.12.2004, the respondent herein had filed appeal before the learned Income Tax Appellate Tribunal, Hyderabad, (for short, 'Tribunal'). The learned Tribunal, on due consideration of the material placed on record and submissions made, held that the holding company and the subsidiary company are separate entities. The expenditure pertaining to one cannot be claimed or allowed in the hands of the other and opined that First Appellate Authority has committed an error in allowing the appeal of the appellant and, therefore, set aside the order of the CIT(A), dated 20.12.2004 and allowed the appeal filed by the respondent herein vide order dated 08.02.2006.

9. Aggrieved by the order of Tribunal dated 08.02.2006, the appellant filed the present appeal.

10. The learned standing counsel for the appellant during the course of hearing submitted that the order of Tribunal is erroneous, unjust and contrary to the facts of the case and bad in law. That the Tribunal has failed to appreciate the material on record and the explanation offered before CIT(A). That the Tribunal grossly erred in concluding that appellant-company has not engaged in business and expenditure claimed by the appellant-

company is totally disallowed without ascertaining and apportioning for the expenditure properly attributed to the assessee business. That even if the tax liability determined for the assessment year under consideration is meager, the business loss to be carried forward denied by the Assessing Officer amounts to Rs.55,68,141/-, which has substantial impact in the subsequent assessment years in which such brought forward business loss were set off.

11. The learned counsel for appellant further submitted that this Tribunal ought to have considered that the expenditure amounting to Rs.50,64,152/- incurred by the appellant pertains to business expenditure for participating in the project allotted to its parent company, which is in line with the appellant's business objective as per its memorandum of association. That the Tribunal ought to have considered that the Assessing Officer failed to verify that with the effort made by the appellant for its parent company in the assessment year 1999-2000 had resulted in earning an income of Rs.1,39,33,163/- and Rs.2,07,86,750/- for the subsequent assessment years and finally prayed to allow the appeal.

12. Learned counsel for appellant relied upon the following decisions in support of appellant contentions:

i) Sri Venkata Satyanarayana Rice Mill Contractors Co. Vs. Commissioner of Income Tax, A.P.II[1];

ii) Commissioner of Income Tax vs. Samsung India Electronics Ltd.,[2];

iii) Commissioner of Income Tax, West Bengal vs. Royal Calcutta Turf Club[3];

13. In **Sri Venkata Satyanarayana Rice Mill Contractors Co.** (supra), the Hon'ble Apex Court held as under:

> **"15.** .... that any contribution made by an assessee to a public welfare fund which is directly connected or related with the carrying on of the assessee's business or which results in the benefit to the assessee's business has to be regarded as an allowable deduction under Section 37(1) of the Act. Such a donation, whether voluntary or at the instance of the authorities concerned, when made to a Chief Minister's Drought Relief Fund or a District Welfare Fund established by the District Collector or any other fund for the benefit of the public and with a view to secure benefit to the assessee's business, cannot be regarded as payment opposed to public policy. It is not as if the payment in the present case had been made as an illegal gratification. There is no law which prohibits the making of such a donation. The mere fact that making of a donation for charitable or public cause or in public interest results in the Government giving patronage or benefit can be no ground to deny the assessee a deduction of that amount under Section 37(1) of the Act when such payment had been made for the purpose of assessee's business."

14. In **Samsung India Electronics Ltd.,** (supra), the Hon'ble Division Bench of Delhi High Court held as under:

> "**24.** ..... The finding of the Tribunal that a part of the advertisement expenditure is reimbursed by the parent company is not under challenge. This itself should settle the issue in favour

[1] (1996) 6 SCC 611
[2] 2012 SCC Online Del 4587
[3] AIR 1961 SC 1028

> of the assessee because even if it is assumed that a part of the expenditure inured for the benefit of the parent company, the assessee is getting compensated for it. The view that in any case, expenditure, the benefit of which inures partly to the assessee and partly to another person, cannot be allowed as a deduction, we are afraid, is not the correct view to take in law since it has been settled by a long line of cases that expenditure incurred by the assessee in the running of his business cannot be disallowed merely on the ground that a part of the expenditure results in some benefit to a third party. ...."

15. In **Royal Calcutta Turf Club** (supra), the issue before the Bench was whether the expenditure incurred for running the school for jockeys is deductible. The business of the respondent was to run race meetings on a commercial scale for which it is necessary to have races of as high an order as possible. For the popularity of the races run by the respondent and to make its business profitable, it was necessary that there were jockeys of requisite skill and experience in sufficient numbers who would be available to the owners and trainers because without such efficient jockeys, the running of race meetings would not be commercially profitable. It was for this purpose that the respondent started the school for training Indian jockeys. If there were not sufficient number of efficient Indian jockeys to ride horses its interest would have suffered, and it might have had to abandon its business if it did not take steps to make jockeys of the necessary calibre available. *Therefore any expenditure which was incurred for*

preventing the extinction of the respondent's business would, in our opinion, be expenditure wholly and exclusively laid out for the purpose of the business of the assessee and would be an allowable deduction.

16. *Per contra,* learned standing counsel for respondent submitted that appeal filed by the appellant is devoid of merits and failed to make out any case, much less the substantial questions of law for consideration. Learned standing counsel further submitted that the Tribunal, on due consideration of the facts and law, had rightly allowed the appeal filed by the Department and the same does not warrant any interference by this Court. He further submitted that the Tribunal while allowing appeal had specifically observed that the holding company and the subsidiary company are separate entities and the expenditure pertaining to one cannot be claimed or allowed in the hands of the other. The Tribunal further observed that expenditure in question is not mere administrative expenditure as in the case of a professional who opens an office and is ready to receive clients, nor an expenditure which has been laid out with an intention to earning income. He also referred to the observations of the Tribunal that the work orders in question were those of the holding company and that the assessee company had deputed its engineers at its own cost for fulfilling the contractual obligation of the holding company.

17. The learned standing counsel for respondent placed reliance on the following decisions:

i) Mira Kulkarni vs. Assistant Commissioner of Income Tax[4];

ii) Crescent Organics (P.) Ltd., v. Deputy Commissioner of Income-tax Range-8(1), Mumbai[5];

iii) P.Amarnath Reddy v. Assistant Commissioner of Income Tax, Central Circle-III(3), Chennai[6]

18. In **Mira Kulkarni** (supra), the assessee was the owner of the property and a portion of property is leased to a company, under an agreement, for being used as a hotel and the assessee was entitled to minimum guaranteed amount per quarter or 30% of gross operating profits whichever was higher; that as per the terms of agreement all facilities, amenities including salaries to staff etc., to be maintained by hotel. The assessee declared income earned under said agreement as income from business and she claimed reduction in respect of foreign travel expenditure, repairs, maintenance expenses and salary under Section 37(1) of the Act, 1961. The Hon'ble High Court of Delhi held that as per the terms of agreement, all facilities, amenities and business activities were to be maintained by the hotel and insofar as the foreign travel

[4] [2012) 17 taxmann.com 160 (Delhi)]
[5] [2014] 49 taxmann.com 128 (Bombay)]
[6] [2021] 128 taxmann.com 244 (Madras)]

expenditure, there was no evidence or material on record showing that said expense was connected with or for purpose of business income and, therefore, rejected the claim.

19. In **Crescent Organics (P.) Ltd.,** (supra), the assessee claimed for deduction under Section 36(1)(iii) of the Act, 1961 in respect of interest paid on borrowals utilized for investments in a foreign company. The Hon'ble Bombay High Court held that investments were not in course of assessee's business, therefore, rejected the claim for reduction. The assessee also claimed business expenditure with regard to foreign travel expenses under Section 37(1) of the Act, 1961. The High Court held that assessee failed to prove that entire foreign travel expenses of directors and auditors were incurred for its business affairs, therefore, rejected the claim of the assessee.

20. In **P.Amarnath Reddy** (supra), the assessee claimed business expenditure of foreign travel expenses of his wife in the capacity of marketing executive of concern and that the same were made for the purpose of business. The High Court of Madras held that the assessee failed to place on record sufficient evidence to prove that his wife was an employee of its proprietary concern and further, there is no evidence on record to establish as to when she

was appointed and what was her salary and ultimately, rejected the claim.

Consideration:

21. Now the point for consideration is whether the business expenditure incurred by the appellant herein for fulfilling contractual obligations of parent company can be considered as business loss of appellant company.

22. Admittedly, the appellant company is a subsidiary company of LIC Energy, Denmark. The appellant company disclosed loss of Rs.55,68,141/- for the assessment year 1999-2000 towards salaries, travelling expenses, rent, printing and stationery, postage, telegrams and telephone charges and other administrative expenses etc. The Assessing Officer during the assessment had taken a view that the appellant company did not carry on business activity during the year, but helped its parent company in completing the projects of the parent company. Therefore, the expenses incurred by the appellant were not for carrying on the business and for market survey etc. of appellant and thus, same cannot be treated as revenue expenses. The A.O., further observed that the appellant incurred were not exclusively for training of the manpower, but for providing support services for the works

contract undertaken by the parent company and are not connected or related to the business activity of the appellant.

23. The Appellate Authority by relying upon the decision of Madras High Court in case of **CIT vs. Electron India**[7] held that business can be said to have been commenced the very moment the party is ready to receive the clients and for the purpose of being in readiness to receive the client, the party has to stay ready for which expenses are required to be incurred to provide services and consultation to its clients. By observing so, the appellate authority allowed the appeal filed by the appellant company and thereby set aside the assessment order of A.O.

24. In **CIT vs. Electron India** (supra), the Hon'ble Madras High Court held as under:

> "Thus in the case of a professional, the date on which he is ready to receive clients should be the date of commencement. In the case of trader, acquisition of goods for sale would amount to commencement, though no sale might have been occurred. In the case of manufacture, the fact that the production unit is set up so as to enable manufacture without actually manufacturing, operations or sale would amount to commencement of business."

25. In considered opinion of this Court the facts of above case and facts of present case are different and hence, does not come to aid of appellant.

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[7] 241 ITR 166

26. However, on appeal by the Department, the Tribunal had taken a different view that assessee company had deputed its engineers at its own cost for fulfilling the contractual obligation of the holding company and as such, expenditure cannot be considered as one incurred wholly and exclusively for the purpose of the assessee's business and further the holding company and the subsidiary company are separate entities and the expenditure pertaining to one cannot be claimed or allowed in the hands of the other.

27. The Bench relying upon the decision in **CIT vs. Chandulal Keshavlal & Co.**[8] held that *"in order to justify a deduction the disbursement must be for reasons of commercial expediency; it may be voluntary but incurred for the assessee's business; and if the expense is incurred for the purpose of the business of the assessee it does not matter that the payment also enures to the benefit of a third party. Another test laid down was that if the transaction is properly entered into as a part of the assessee's legitimate commercial undertaking in order to facilitate the carrying on of its business it is immaterial that a third party also benefits thereby."*

28. At this stage, it is relevant to refer Section 37 of the Act, 1961, which reads as under:

[8] 1951 SCC 440

"**S.37.** (1) Any expenditure (not being expenditure of the nature described in Sections 30 to 36 and not being in the nature of capital expenditure or personal expenses of the assessee), laid out or expended wholly and exclusively for the purposes of the business or profession shall be allowed in computing the income chargeable under the head "Profits and gains of business or profession".

Explanation 1.—For the removal of doubts, it is hereby declared that any expenditure incurred by an assessee for any purpose which is an offence or which is prohibited by law shall not be deemed to have been incurred for the purpose of business or profession and no deduction or allowance shall be made in respect of such expenditure.

Explanation 2.—For the removal of doubts, it is hereby declared that for the purposes of sub-section (1), any expenditure incurred by an assessee on the activities relating to corporate social responsibility referred to in section 135 of the Companies Act, 2013 (18 of 2013) shall not be deemed to be an expenditure incurred by the assessee for the purposes of the business or profession.

[*Explanation 3.*—For the removal of doubts, it is hereby clarified that the expression "expenditure incurred by an assessee for any purpose which is an offence or which is prohibited by law" under *Explanation 1,* shall include and shall be deemed to have always included the expenditure incurred by an assessee,—

(*i*) for any purpose which is an offence under, or which is prohibited by, any law for the time being in force, in India or outside India; or

(*ii*) to provide any benefit or perquisite, in whatever form, to a person, whether or not carrying on a business or exercising a profession, and acceptance of such benefit or perquisite by such person is in violation of any law or rule or regulation or guideline, as the case may be, for the time being in force, governing the conduct of such person; or

(*iii*) to compound an offence under any law for the time being in force, in India or outside India].

(2) [***]

(2B) Notwithstanding anything contained in sub-section (1), no allowance shall be made in respect of expenditure incurred by an assessee on advertisement in any souvenir, brochure, tract, pamphlet or the like published by a political party."

29. As per the decision of Hon'ble Apex Court in **Saravana Spinning Mills Pvt. Ltd.**, (supra), the prerequisites for allowing reduction under Section 37 of the Act, 1961 are as under:

"(a) if the expenditure does not fall within sections 30 to 36;

(b) that it should have been incurred in the accounting year;

(c) that it should be in respect of a business carried on by the assessee;

(d) that it should not be in the nature of capital expenditure and

(e) that it should be spent wholly and exclusively for business.

30. An analysis of the authorities, precedents relied upon by both the counsels would make it clear that business can be said to have been commenced, the very moment the party is ready to receive the clients. For the purpose of being ready to receive the client to provide services and consultation to its clients, the party has to stay ready for which expenses are required to be incurred.

31. Perusal of the record would show that the holding company had received five orders to supply LEAK detection and location system to India apart from several enquiries on other modeling software. The appellant company incurred expenditure for overseeing and execution of contracts entered by the holding company. It is also clear that the appellant company did not undertake any business on its own and thus, the expenses incurred by the appellant company are not occasioned in the process or for its own business. Therefore, the expenditure incurred by the appellant company cannot be considered as expenditure in connection with its business or incidental to its business.

32. For allowing loss, the expenditure must be connected with or related to the business carried on by the assessee and profits and gains therein. However, in the present case, the losses incurred are for the purpose of giving support services to the holding company and the assessee did not derive any profit and gain from such expenditure, therefore, the loss incurred by the appellant company is not related to its own business. It is relevant to note that the holding company and the subsidiary company are separate entities and the expenditure pertaining to one entity cannot be claimed or allowed in the hands of the other.

33. The judgments relied upon by the learned counsel for appellant will not support the contentions of the appellant company since the expenses incurred in those cases are part of its own business and are related to preparedness of those companies towards training and to strengthen the business. However, in the present case, it is not the case of the appellant that expenses are incurred for its own business or towards training etc., but were incurred for overseeing the project of the holding company and was incurred towards travel, administrative and other expenses of its staff and personnel.

34. As per Section 37 of the Act, 1961, the prerequisites for allowing deduction are that the expenditure should have been incurred in respect of a business carried on by the assessee and should be spent wholly and exclusively for its own business. In the present case, admittedly, the expenditure sought to be deducted was incurred for overseeing the project of the holding company. Further, in order to be deductible as a business loss, the expenditure must be in the nature of trading loss, not as capital loss springing directly out of trading activity and it must be incidental to the business of the assessee. It is not sufficient that it falls on the assessee in some other capacity or is merely connected with its business and also the amount incurred by the assessee which is not in the ordinary course of business cannot be allowed as a deduction.

35. In the light of above discussion and legal position, the amount incurred by the appellant company cannot be considered as revenue expenditure of the appellant company and thus, not eligible for reduction under Section 37 of the Act, 1961.

36. In view of above discussion, this Court is of the considered view that the appellant failed to make out any case to interfere with the impugned order passed by the Income Tax Appellate Tribunal

and thus, the Appeal fails and is accordingly dismissed. There shall be no order as to costs.

Pending miscellaneous applications, if any, shall stand closed.

P.SAM KOSHY,J

LAXMI NARAYANA ALISHETTY,J

Date: 28.06.2024
Kkm

Note:LR copy to be marked: Yes

HONOURABLE SRI JUSTICE P.SAM KOSHY
AND
HON'BLE SRI JUSTICE LAXMI NARAYANA ALISHETTY

INCOME TAX TRIBUNAL APPEAL NOs.561 OF 2006

Date: 28.06.2024

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